RECORD AND BRIEFS

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In the Supreme Court of the United States

EXPRESSIONS HAIR DESIGN, *et al.*,
Petitioners,

v.

ERIC T. SCHNEIDERMAN, IN HIS OFFICIAL CAPACITY AS ATTORNEY GENERAL OF THE STATE OF NEW YORK, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF SCHOLARS OF BEHAVIORAL ECONOMICS AS *AMICI CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTEREST OF *AMICI*[1]

Amici are seven professors in the fields of economics, psychology, and law who engage in significant research and teaching on behavioral economics and its application to consumer economic behavior. See Appendix (listing individual professors joining this brief). This brief addresses issues that are within *amici's* particular areas of scholarly expertise.

Behavioral economics applies psychological insights into human behavior to explain economic decision-making. Behavioral economics has shown that consumer behavior in many situations systematically departs from that predicted by traditional economic theory, which assumes more purely rational, mathematical decision making and often fails to fully explain the real-world experience of the marketplace.

Amici believe that this case—which concerns the significance of the framing effect under the First Amendment—presents the first petition for certiorari based squarely on behavioral economic theory. As relevant here, behavioral economics reveals that

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[1] No counsel for any party has authored this brief in whole or in part, and no person other than *amici* or their counsel has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. *Amici* advised counsel for Petitioners of their intent to file this brief around April 28, 2016, and counsel gave consent to the filing at that time. *Amici* provided counsel for Respondent Eric. T. Schneiderman with notice of their intent to file on June 2, 2016, and counsel consented on June 6, 2016. *Amici* belatedly learned that Respondents Cyrus R. Vance and Kenneth P. Thompson were separately represented on June 10, 2016, and immediately advised counsel of *amici's* intent to file this brief. Counsel for Mr. Vance and Mr. Thompson consented to the filing the same day.

consumers' purchasing decisions are influenced significantly by the way in which information—including price information—is framed. The state no-surcharge laws at issue in this case limit the manner in which merchants frame the costs of using credit cards as a payment device, rather than cash or debit cards. *Amici* possess expertise on how such framing affects consumer behavior.

SUMMARY OF ARGUMENT

Merchants pay fees ("swipe fees") on every credit card transaction, and predictably, they pass the cost of these fees on to their customers. Under the "no-surcharge" laws of New York and several other states, however, merchants are permitted to charge different prices to cash and credit customers, but are restricted in the way they describe the mathematical relationship between the two prices. They can provide "discounts" for cash purchases, but are criminally prohibited from setting "surcharges" on credit card transactions. Thus, a merchant could advertise a regular price of $100 and offer a $2 cash discount, but could not advertise a regular price of $98 with a $2 surcharge for credit.

Under traditional economic theory, the market impact of a "cash discount" should be the same as the impact of a "surcharge." Credit card customers pay more, and cash customers pay less, regardless of the label attached. We would thus expect the promise of a cash discount to induce consumers to forego paying with their credit cards to the same extent penalizing them with a surcharge would do so. After all, surcharges and cash discounts are just two ways of conveying identical information about the relationship between two prices.

But pioneering work in the field of behavioral economics teaches that people do not make decisions based strictly on rational calculations. Instead, their decisions can be highly influenced by the manner in which information is presented: a perceived reward garners a minor, positive reaction, while a perceived penalty produces a strong, negative reaction. In this way, framing is a material part of any communication.

In the context of credit card surcharging, behavioral economics has shown that consumers react very differently to discounts and surcharges. A discount is perceived as a "reward" for a cash purchase, generating a mild, positive reaction. A surcharge is perceived as a "penalty" for a credit purchase, garnering a much stronger, negative reaction. In this way, a merchant's ability to incentivize use of a preferred payment method is diminished by the limits no-surcharge laws place on the way the merchants describe the price differential.

ARGUMENT

I. Behavioral economics explores the effect of psychological, sociological, and related factors on real-world economic decisions.

Behavioral economics is a relatively new field—about 35 years old—that stands at the intersection of traditional economics and psychology. *See e.g.*, Esther-Mirjam Sent, *Behavioral Economics: How Psychology Made Its (Limited) Way Back Into Economics*, 36 History of Political Economy 735 (2004) [hereinafter *Behavioral Economics*]; Elizabeth Kolbert, *What Was I Thinking?* The New Yorker, Feb. 25, 2008, *available at* http://www.newyorker.com/magazine/2008/02/25/what-was-i-thinking; Alain Samson, *The Behavioral Economics Guide 2015*, at 1-2 [hereinafter *The Behavioral Economics Guide*], *available at* https://www.behavioraleconomics.com/the-behavioral-economics-guide-2015/.

Traditional economics treats human beings as relentlessly rational actors who consistently work to maximize their self-interest. Richard H. Thaler, *Misbehaving: The Making of Behavioral Economics*, at 4-5 (2015) [hereinafter *Misbehaving*]. Behavioral economists challenge that view by exploring and elucidating the ways in which our decision making is clouded or distorted by our limited cognitive abilities and willpower, our unconscious biases, and the unacknowledged mental shortcuts we use all the time when problem-solving. *Id.* at 5-6; *Behavioral Economics*, *supra*, at 747-50.

One of the field's pioneers, University of Chicago professor Richard Thaler, has described behavioral

economics as an "enriched version of economic theory," by which he means "economics done with strong injections of good psychology and other social sciences." *Misbehaving*, *supra*, at 9. In the last few decades, the field has enjoyed growing prominence in university economics' departments and in policymaking circles. *Id.*; *The Behavioral Economics Guide*, *supra*, at 2. Some of its key observations and findings have been presented to the lay public in such popular recent works as Daniel Kahneman, *Thinking, Fast and Slow* (2011) [hereinafter *Thinking, Fast and Slow*] and Dan Ariely, *Predictably Irrational* (2008). In 2008, Thaler and law professor Cass Sunstein co-authored *Nudge*, in which they showed how policymakers could draw on the insights of behavioral economics to improve public policies. Richard H. Thaler & Cass R. Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (2008) [hereinafter *Nudge*].

Much of the work of behavioral economists is done through field studies and the literature is rife with interesting examples, some of which will be described below. Although not a formal study, one example from Richard Thaler helps to show what makes behavioral economics different.

Early in his scholarly career, Thaler incurred the displeasure of his students when he gave an exam in which the average score turned out to be 72 points out of a possible 100. *Misbehaving*, *supra*, at 3. As Thaler explained, his students' anger was odd because he had already told them that "the average numerical score on the exam had absolutely no effect on the distribution of grades." *Id.* Any exam that scored over an 80 would receive an "A," those over 65 would get a "B," and those

over 50 would get a "C." According to Thaler, his students were still not happy. *Id.*

On the next exam, Thaler made the total number of points available 137, instead of 100. *Id.* The average score was 96 points and some students scored above 100. According to Thaler, his students "were delighted," and the over-100 scores produced "a reaction approaching ecstasy." *Id.* at 4. Under traditional economic theory, a score of 96 out of 137 should be met with the same reaction as a score of 72 out of 100—they are mathematically equivalent. *Id.* That was not their response, however. Although Thaler does not make it explicit, no doubt the students' traditional associations with scores of 90 and above representing "A"-level work had influenced their reactions.

Behavioral economics explores these very human—and typically unseen—cognitive and emotional predispositions, which so heavily influence the decisions we make. Amongst other benefits, that exploration allows the public to understand better the practical effects of laws and policies.

II. The way in which options are framed materially affects consumer choices.

Behavioral economists have discovered a cognitive bias—a systematic way in which people misprocess information—which they call the "framing effect." The framing effect reflects the fact that people will reach different decisions depending on the way information is presented, despite the fact that the information presented is not substantively altered by its presentation. *See* Amos Tversky & Daniel Kahneman,

The Framing of Decisions and the Psychology of Choice, Science, Jan. 30, 1981, at 453-58.

For example, in one early experiment doctors at Harvard Medical School were given information about the short-term outcomes of selecting surgery to treat lung cancer. *Thinking, Fast and Slow*, *supra*, at 366-67. Half the doctors were told that the one-month survival rate following surgery was 90 percent. *Id.* at 367. The other half was told that the one-month mortality rate was 10 percent. *Id.* In other words, all the doctors were effectively given the same information, if analyzed rationally. The way in which that information was presented—whether as a one-month survival rate or a one-month mortality rate—should not have influenced their decisions as to whether surgery was the best course of treatment.

But that is not what happened. Instead, when the surgery outcomes were framed in terms of *survival* rates, 84 percent of the doctors selected surgery; but when the outcomes were framed in terms of *mortality* rates, just 50 percent chose surgery. *Thinking, Fast and Slow*, *supra*, at 367. The frame through which the information was presented mattered because emotions, not just rational considerations, play a powerful role in human decisionmaking. As Daniel Kahneman puts it, "mortality is bad, survival is good, and 90% survival sounds encouraging whereas 10% mortality is frightening." *Id.*

In another classic example, Kahneman and Tversky again showed that framing exerts enormous influence over the decisions that people reach. In the "Asian disease" problem, Kahneman and Tversky asked a group of subjects to choose between two competing

plans to address a disease expected to kill 600 people. *See* Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. Bus. No. 4, Part 2 S251-78 (1986) [hereinafter *Rational Choice*]. In the first experiment, they framed the outcomes of the alternative plans in terms of the number of people who would be "saved," and in the second experiment they framed the outcomes in terms of the number of people who would "die." *Id.* at S260.

Although the identical information was conveyed in both frames, the study participants overwhelmingly chose one plan when the outcomes were characterized in terms of lives "saved," and overwhelmingly chose the *other* plan when the outcomes were characterized in terms of deaths. *Rational Choice*, *supra*, at S260. The hypothetical the participants were asked to consider was as follows:

> Imagine that the U.S. is preparing for the outbreak of an unusual Asian disease, which is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows:
>
> If Program A is adopted, 200 people will be saved.
>
> If Program B is adopted, there is a 1/3 probability that 600 people will be saved, and 2/3 probability that no people will be saved.

Id. In this formulation of the problem, 73 percent of the participants chose Program A and just 28 percent chose Program B. *Id.* In other words, the respondents were

risk-averse, and the guarantee of saving 200 lives was far more attractive than the gamble entailed in Program B. *Id.*

But when the competing programs were described in terms of the number of people who would *die*, the respondents selected the gamble, rather than the guarantee. In this second experiment, the participants were given the same hypothetical, but were presented with the following program choices:

> If Program C is adopted, 400 people will die.
>
> If Program D is adopted, there is 1/3 probability that nobody will die and 2/3 probability that 600 people will die.

Rational Choice, at S260. Faced with these scenarios, just 22 percent of respondents selected Program C, and 78 percent selected Program D. *Id.* That is not what we would expect from rational decisionmaking. Programs A and C convey the identical information (200 people will be saved and 400 people will die), as do Programs B and D. So, a rational decisionmaker should select A and C with the same frequency and B and D with the same frequency. But the results show that the percentages are inverted depending on the frame used to present the problem. The emotional trigger words—people who would be "saved" versus those who would "die"—made all the difference in how the participants evaluated the alternative programs.[2]

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[2] Research has shown that, "People appear to exhibit a general tendency to be risk seeking when confronted with negatively framed problems and risk averse when presented with positively framed problems." Cleotilde Gonzalez, et al., *The Framing Effect*

Indeed, even public health officials, people we might expect to know better, have proven vulnerable to the framing effects of the Asian disease problem. *Thinking, Fast and Slow*, *supra*, at 368.

Another study reflects that use of costly bank overdraft services is *reduced* when customers are offered a discount on overdraft fees as compared with customers who were merely reminded that overdraft services were available for a fee. Sule Alan, Mehmet Cemalcilar, Dean Karlan, & Jonathan Zinman, *Unshrowding Effects on Demand for a Costly Add-on: Evidence from Bank Overdrafts in Turkey* (March 2016), *available at* http://www.dartmouth.edu/~jzinman/Papers/overdraft_turkey_March2016.pdf. In the abstract, one would expect a discount offer to *increase* use. The counter-intuitive result of the study, however, appears to have been caused in part by the fact that mentioning a discount more strongly reminded customers of the fees they pay for overdraft services. *Id.* at 21-24.

Framing is so consequential because people are lazy and naturally inclined to accept problems as they are framed, rather than investigate further to understand how perceptions affect the choices they make. *Thinking, Fast and Slow*, *supra*, at 367. As Kahneman explains, "most of us passively accept the decision problems as they are framed and therefore rarely have an opportunity to discover the extent to which our preferences are *frame-bound*, rather than *reality-bound*." *Id.*

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and Risky Decisions: Examining Cognitive Functions with fMRI, Economic Psychology, Nov. 5, 2003, at 2.

The framing effect and the cognitive biases it exploits are not merely interesting trivia. Rather, the public policy implications of different frames can be profound. For example, the "miles per gallon" formulation for vehicle fuel efficiency is misleading compared to a "gallons per mile" frame. *Thinking, Fast and Slow*, *supra*, at 371-72. Consistently, as discussed in the next section, framing effects also have a material impact on consumers in the context of credit surcharging and discounts. Thus, framing is a significant part of the content of any communication, especially when used consciously.

III. Surcharge restrictions selectively limit the framing of credit costs with measurable impacts.

As relevant here, the framing effect is influenced by a cognitive bias known as "loss aversion." Simply put, losses provoke more extreme responses than gains do. As Cass Sunstein and Richard Thaler put it, "[r]oughly speaking, losing something makes you twice as miserable as gaining the same thing makes you happy." Richard R. Thaler & Cass R. Sunstein, *Nudge*, *supra*, 33; *Rational Choice*, *supra*, at S258. Thus, the negative feeling of loss triggered by having to pay a surcharge is more pronounced than any positive feeling that might be generated through gaining a discount.

The forgoing psychological effects have a material impact on consumer behavior when the law prohibits framing a price difference as a credit-card "surcharge" rather than as a cash "discount." When consumers are offered a small discount for paying in cash, they are often willing to ignore it for the sake of convenience, treating the discount as a lost opportunity cost. When

consumers are asked to pay a premium on top of the perceived base price, however, they perceive it as an out-of-pocket cost. Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behav. & Org. 39, 45 (1980). As a result, "people will more readily forgo a discount than pay a surcharge. The two may be economically equivalent, but they are not emotionally equivalent." *Thinking, Fast and Slow*, *supra*, at 364. Thus, surcharging provides merchants with a much stronger tool for incentivizing the use of less-expensive payment methods.

This is not merely theoretical. A Dutch study showed that consumers have a very negative reaction to surcharges (74 percent of respondents deemed them "bad" or "very bad"), but not an especially positive reaction to cash discounts (only 22 percent viewed them as "good" or "very good"). E. Vis & J. Toth, *The Abolition of the No-Discrimination Rule, Report For European Commission Directorate General Competition* 12 (2000), *available at* http://www.creditslips.org/files/netherlands-no-discrimination-rule-study.pdf. Consistently, an internal study conducted by IKEA confirmed what the Dutch study suggests: surcharging leads to decreased use of credit cards. Scott Schuh, et al., *An Economic Analysis of the 2010 Proposed Settlement Between the Department of Justice and Credit Card Networks*, Public Policy Discussion Papers, Federal Reserve Bank of Boston, No. 11-4, 26-27 *available at* http://www.bostonfed.org/economic/ppdp/2011/ppdp1104.pdf. "This may be why banks and credit card networks are opposed to surcharges." *See id.*

In turn, the ability to incentivize the use of cash and other inexpensive payment methods is significant.

Merchants have clear incentives to accept credit cards, including increased profitability and operational efficiency. *See* Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. Rev. 1321, 1342, 1353; Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*, 12 Stan. J.L. Bus. & Fin. 425, 483 (2007). But merchants gain little or no additional benefit from accepting rewards cards. Swipe fees are substantially higher on rewards cards, but they do not generate an increase in consumer spending or operational efficiencies for merchants. *See* Andrew Ching & Fumiko Hayashi, *Payment Card Rewards Programs and Consumer Payment Choice* 4 (Fed. Reserve Bank of Kansas City, Working Paper No. 06-02, 2006), *available at* http://www.kansascityfed.org/PUBLICAT/PSR/RWP/Ching_Hayashi_Paper.pdf.

Thus, in a free market, merchants would often accept credit cards, but charge more for premium rewards and other high-fee cards. Through these pricing signals, consumers would either be discouraged from using high-cost cards or would pay for the benefits they receive. No-surcharge laws, however, make it impossible for merchants to charge consumers based on the cost of the consumer's choice of card, as the surcharge for a rewards card would be a surcharge above the cost of a cash transaction. Likewise, a cash discount is ineffective at incentivizing use of lower cost cards because a cash discount necessarily treats all non-cash transactions the same way.

CONCLUSION

A "surcharge" and a "cash discount" communicate an economically identical reality, but consumer perceptions are materially altered by the way in which this reality is framed for them by merchants. Thus, no-surcharge laws burden merchants' ability to communicate information in a way that many are likely to prefer because it more effectively incentivizes consumer choices.

Respectfully submitted,

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APPENDIX

APPENDIX

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